8/12/83 B4750-1

Financial Markets

Irving Trust

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Friday (Noon) Aug. 12, 1983

With the Treasury auctions out of the way, the financial markets can now turn to factors that are less tactical and more fundamental. Auction time is always an opportunity for positioning. It fosters a really grand ballet in which government securities dealers try to outwit potential customers. All the financial-markets players are participants in this dance. Now that the tactical opportunity has passed, the market can get down to business.

The government always auctions all its debt. The question is, at what price? Dealers become understandably reticent to "buy the auction" if the market's mood is down. Dealers may prefer to sell off some inventory, take a loss on the market's decline, and try to make it up by bidding at the auction and reselling later at better prices. They might try to set "short" positions before the auction and hope for an improved price performance at auction. Many different strategies are possible. However, all have the common element of realizing that the auctions will be done at some price, and that if sufficient customer demand doesn't develop, the dealers themselves will own the government paper.

The dealers are kept "honest" in this game by the existence of other dealers and by sophisticated final purchasers. However, the laws of economics do not provide a consistent, reliable valuation of bond prices, so that short-term price swings can be volatile and disconcerting. In the recent auction, the new long bond carried a yield of over 12%, a sizable change from the 11.68% yield on July 29, just four business days before the auction.

So far this week (up to Friday), the long-term markets have done better. Yet short-term rates remain firm and will probably continue to rise. But since no new government supply is coming on stream for a while, the market has a chance to consider current yield levels in isolation from the previous tactical environment. When one looks at the fundamentals, bonds look more attractive--and while still prone to risk--perhaps worth it.

July retail sales softened, refocusing attention on the interest sensitivity of the economy. Mortgage rates are already so high they clearly are slowing the housing market. Even if short-term rates firm to try and rein in money growth, can the long-term market back up much more? Will the Fed pursue its new M1 "target"--excuse me, "monitoring zone"--without regard to other consequences? How much more of an interest rate backup can auto sales withstand? The answers to these types of questions have reassured potential bond buyers. It seems unlikely that long rates will push to much higher levels, even if the Fed continues to let the funds rate rise a modest 10 basis points per week. How much longer? September? October? The market is also reassured by better looking M2 and M3 aggregates for July. It looks like M1 will stand alone as a problem. With these circumstances, it is possible that the bond market could cease to back up and to consider a modest rally, even given prospects that short-term rates might move up slowly for a while longer. The Fed will have ample excuse to lower interest rates when economic growth slows, whether or not M1 remains over target. For now, this news seems to reassure the bond market.

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Market Yields

	8/12/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	10.50%	15.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	11.00
Federal Funds	9.63	9.63	10.38
Repurchase Agreements	9.50	9.50	9.63
U.S. Treasury Issues			
Bills			
3 months	9.85	9.77	9.58
6 months	10.27	10.23	11.05
1 year	10.68	10.62	11.90
Coupons			
2 years	11.24	11.25	12.80
4 years	11.69	11.69	13.39
7 years	11.91	11.99	13.47
10 years	12.01	12.10	13.40
Long Bond	11.97	12.11	13.04
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.70	9.65	10.05
3 months	10.00	9.90	11.20
6 months	10.40	10.30	11.85
1 year	11.00	10.90	12.25
Banker's Acceptances			
1 month	9.68	9.55	10.60
3 months	10.05	9.98	11.15
6 months	10.51	10.50	11.80
Eurodollar Deposits			
1 month	9.88	10.00	11.38
2 months	10.25	10.25	12.00
3 months	10.44	10.50	12.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.53	9.40	9.14
1 month	9.84	9.71	10.36
3 months	10.13	10.00	10.67
Bank Holding Companies			
1 month	9.45	9.33	10.22
Dealer Placed:			
3 months	10.15	9.94	10.67
New AA Corporate Utility Bond	13.30	13.45	15.60
Tax Exempt			
6 month Project Notes	5.65	5.25	6.45
1 year AAA Bond	5.70	5.50	8.00
5 year AAA Bond	7.10	7.10	8.75
20 year AAA Bond	9.50	9.30	11.10

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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